

**DEPARTMENT OF VETERANS SERVICES  
AND  
THE VETERANS SERVICES FOUNDATION**

**REPORT ON AUDIT  
FOR THE PERIOD  
JANUARY 1, 2005 THROUGH MARCH 31, 2006**



## **AUDIT SUMMARY**

Our audit of the Department of Veterans Services and the Veterans Services Foundation for the period January 1, 2005 through March 31, 2006, found:

- proper recording and reporting of transactions, in all material respects, in the Commonwealth Accounting and Reporting System;
- a material weakness in internal controls; and
- instances of noncompliance or other matters required to be reported.

Management has responsibility for establishing and maintaining effective internal controls. Internal control is a framework designed to provide reasonable assurance over the reliability of financial records, effectiveness, and efficiency of operations including safeguarding of assets, and compliance with applicable laws, rules, and regulations.

Last year, we recommended that the Department of Veterans Services management document its policies and procedures and begin the process of establishing a base line to evaluate its internal controls. While Veterans Services did document its accounting policies and procedures, staff are not following the document, and the internal control environment remains unchanged since the last audit.

Generally, we found that management oversight, supervisory reviews, and reconciliations at Veterans Services do not achieve the objectives above and this contributed to a number of problems. We found that Veterans Services does not have adequate, documented policies and procedures and this contributed to a number of problems. Our review also found Veterans Services did not reasonably ensure conformity and adherence to state and federal laws, regulations, and contracts. Detailed in this report are several issues resulting from these lack of controls.

Much of the daily operations depend on staff who continue to operate as they did before the creation of Veterans Services. Although Veterans Services is planning to implement a new system, the internal control processes necessary to gather, review, and verify data to ensure accurate and timely information does not exist.

When management begins conducting their review of these financial management issues, they should begin with establishing a proper oversight structure. Currently the majority of executive management is located in Richmond, Virginia while the day-to-day administrative operations occur in Roanoke, Virginia. Without adequate, direct, and experienced management oversight, the issues noted in this audit report will not be resolved.

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## **INTRODUCTION**

On July 1, 2003, the Department of Veterans Services combined the operations of the Department of Veterans' Affairs, the Veterans Care Center and its Board of Trustees and Virginia Department of Education's program for veterans education. The Department of Veterans' Affairs assisted veterans and their families in applying for veterans benefits and operated the Virginia Veterans Cemetery in Amelia, Virginia. The Virginia Veterans Care Center Board of Trustees was a separate state agency and managed, controlled, maintained, and operated the Virginia Veterans Care Center, a long-term care facility. The Board of Trustees contracted with various private companies to operate the center. In addition to these two primary veterans service functions, the Department of Education reviewed, approved, and monitored post-secondary education and training programs for veterans under the State Approving Agency for Veterans Education program.

## **INTERNAL CONTROL ISSUES**

### **Background**

Last year, we recommended that the Department of Veterans Services (Veterans Services) document its policies and procedures and begin the process of having a base line to evaluate its internal controls. While Veterans Services did document its accounting policies and procedures, staff are not following the document, and the internal control environment remains unchanged since the last audit.

During the past year, Veterans Services' management has used former state financial officers to assist the agency in addressing its accounting and internal control system needs. These individuals began addressing a number of problems. They have not consistently provided the on-site supervision and monitoring necessary to address Veterans Services' internal control environment.

Much of the daily operations depend on staff who continue to operate as they did before the creation of Veterans Services. Although Veterans Services is planning to implement a new system, the internal control processes necessary to gather, review, and verify data to ensure accurate and timely information does not exist.

Below is a brief discussion of the concept and ideas surrounding the development and results of a sound system of internal controls. Following this discussion are our internal control findings.

### **Internal Control**

We have used the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as COSO, and an internationally recognized organization, to help Veterans Services develop a sound system of internal control.

This information paraphrases the COSO report on the framework for internal control. We believe that this document is the clearest articulation of what is a sound system of internal control. We have included this information to provide our office's expectations when reviewing whether an entity such as Veterans Services has good internal controls.

### **Meaning of Internal Control**

Internal control means different things to different people. This causes confusion among business people, legislators, regulators, and others. The resulting miscommunication and different expectations cause problems within an enterprise. These problems compound when laws, regulations, and rules use the term, but do not clearly define its meaning.

Internal control is broadly defined as a process, affected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with applicable laws and regulations

The first category addresses an entity's basic objectives, including performance goals and the safeguarding of resources. The second relates to the preparation of reliable financial information, including financial statements and selected financial data derived from these statements. The third deals with complying with those laws and regulations to which the entity is subject. These distinct but overlapping categories address different needs and allow a directed focus to meet the separate needs.

Internal control systems operate at different levels of effectiveness. One can judge internal control effectiveness in each of the three categories, if the board of directors and management has reasonable assurance that:

- they understand how the entity is achieving its operation's objectives;
- published financial statements are being prepared reliably; and
- compliance with applicable laws and regulations is occurring.

While internal control is a process, its effectiveness is a state or condition of the process at one or more points in time.

Internal control consists of five interrelated components. These components come from the way management runs a business, and integrates them with the management process. Although the components apply to all entities, small and mid-size entities may implement them differently than large ones. Its controls may be less formal and less structured, yet a small entity can still have effective internal control. Internal control components are listed below.

### *Control Environment*

The control environment sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure. Control environment factors include the integrity, ethical values, and competence of the entity's people; management's philosophy and operating style; the way management assigns authority and responsibility, and organizes and develops its people; and the attention and direction provided by the board of directors.

### *Risk Assessment*

Every entity faces a variety of risks from external and internal sources and must assess their impact. A precondition to risk assessment is establishment of objectives, linked at different levels and internally consistent. Risk assessment is the identification and analysis of relevant risks to achievement of the objectives, forming a basis for determining how the organization manages the risks. Because economic, industry, regulatory, and operating conditions will continue to change, mechanisms are needed to identify and deal with the special risks associated with change.

### *Control Activities*

Control activities are the policies and procedures that help ensure personnel carry out management directives. They help ensure personnel take the necessary actions to address risks to achieve the entity's objectives. Control activities occur throughout the organization, at all levels and in all functions. They include a range of activities as diverse as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets, and segregation of duties.

### *Information and Communication*

Organizations must identify, capture, and communicate pertinent information in a form and timeframe that enables people to carry out their responsibilities. Information systems produce reports, containing operational, financial, and compliance-related information, that make it possible to run and control the organization. These controls deal not only with internally generated data, but also information about external events, activities, and conditions necessary to support informed decision-making and external reporting. Effective communication also must occur in a broader sense, flowing down, across, and up the organization. All personnel must receive a clear message from top management that they must take control responsibilities seriously.

Employees must understand their own role in the internal control system, as well as how individual activities relate to the work of others. They must have a means of communicating significant information upstream. There also needs to be effective communication with external parties, such as customers, suppliers, regulators, and taxpayers.

### *Monitoring*

Internal control systems need to be monitored--a process that assesses the quality of the system's performance over time. The organization accomplishes monitoring through ongoing review activities, separate evaluations, or a combination of the two. Ongoing monitoring occurs in the course of operations.

It includes regular management and supervisory activities, and other actions personnel take in performing their duties. The scope and frequency of separate evaluations will depend primarily on an assessment of risks and the effectiveness of ongoing monitoring procedures. Personnel must feel free to report internal control deficiencies, with serious matters reported to top management or the board.

There is synergy and linkage among these components, forming an integrated system that reacts dynamically to changing conditions. The internal control system is intertwined with the entity's operating activities and exists for fundamental business reasons. Internal control is most effective when controls are part of the entity's infrastructure and the essence of the organization. "Built in" controls support quality and empowerment initiatives, avoid unnecessary costs, and enable quick response to changing conditions.

There is a direct relationship between the three categories of objectives, which are what an entity strives to achieve. Components represent the mechanism needed to achieve the objectives. All components are relevant to each objectives category. When looking at any one category--the effectiveness and efficiency of operations, for instance--all five components must be present and functioning effectively to conclude that internal control over operations is effective.

The internal control definition--with its underlying fundamental concepts of a process, affected by people, providing reasonable assurance--together with the categorization of objectives and the components and criteria for effectiveness, and the associated discussions, constitute this internal control framework.

#### What Internal Control Can Achieve

Internal control can help an entity achieve its performance targets, and prevent the loss of resources. It can help ensure reliable financial reporting and it can help ensure that the organization complies with laws and regulations, avoiding damage to its reputation and other consequences. In sum, it can help an entity get to where it wants to go, and avoid pitfalls and surprises along the way.

## **INTERNAL CONTROL AND COMPLIANCE FINDINGS**

### **Develop, Implement and Maintain Management Oversight and Review**

Inherent in any system of internal controls is a dependence on management review, oversight, and involvement. The first line of defense in maintaining this system of accountability is supervisors who question and understand the processes they oversee and are able to provide adequate guidance to staff. These controls also provide a check on how well staff is doing their jobs and the assurance that management is getting timely and reliable information to make decisions.

Reconciliations and reviews are fundamental functions to any well-running system of internal controls and accountability. Both of these functions provide checks against outside sources as to the processing of financial transactions by providing information on the timely receipt, payment, and accuracy of transactions processed by vendors, customers and others, such as the bank. Finally, these two processes also provide information on the performance of the staff processing the transactions. Errors, miscoding, duplicate transactions, and untimely processing can all indicate whether whole sections or individuals either do not understand their duties and require additional training, or are just failing to perform their job.

Generally, we found that management oversight, supervisory reviews, and reconciliations at Veterans Services do not achieve the objectives above and this contributed to a number of problems. Detailed below are several issues resulting from this lack of management oversight and review.

#### Ensure Accurate Time and Leave Reporting

Veterans Services has three different time and leave tracking mechanisms used by administrative personnel. Veterans Services requires administrative personnel to complete daily time logs to report the hours worked for each service area within the department, in order to allocate administrative personnel costs. In accordance with the Fair Labor Standards Act, the Veterans Services' non-exempt employees must either complete timesheets or clock-in and clock-out, depending on the employees' section. Finally, Veterans Services requires all personnel to complete leave slips for leave hours taken or compensatory leave earned.

We found Veterans Services management does not adequately monitor that employees accurately report their time and leave hours. Daily time logs, timesheets, and leave documentation did not consistently reconcile. For example, if an employee reported leave on their timesheet and their daily time log, but did not document this leave taken on a leave slip, then there was no reduction of employees leave balances. We also found evidence of inconsistent controls over supervisory time and leave monitoring.

#### Strengthen Controls over the Small Purchase Charge Card Program

Veterans Services management does not adequately control or monitor their small purchase charge card program. Our review found inadequate documentation for purchases, missing monthly charge card statements, evidence that cardholders were not properly maintaining purchase logs, and inappropriate card limits granted by program administrators but not authorized by supervisors.

#### Improve Petty Cash Controls

We also found a lack of consistent controls regarding the use, monitoring, and reconciliation of petty cash funds. Without adequate review and oversight over petty cash transactions, Veterans Services is more susceptible to fraud, waste, and abuse.



### Properly Report Construction in Progress

Veterans Services is currently working on two capital projects but did not report a construction in progress amount at the 2005 fiscal year-end. No specific individual within the agency has responsibility of determining the construction in progress amount. By not properly reporting construction in progress for fiscal year 2005, Veterans Services underreported its fixed assets for the fiscal year.

#### **Conclusion**

Veterans Services should ensure that there is adequate framework of management oversight and supervisory review. The current lack of consistent controls results in the agency being more susceptible to fraud, waste, and abuse. Veterans Services management should ensure the maintenance of adequate supporting documentation and timely and complete reconciliations and reviews.

### **Document Policies and Procedures and Monitor Compliance**

Also included in an adequate internal control environment is the establishment of documented policies and procedures that will provide reasonable assurance that agency programs achieve their intended results, that resources are used according to the agency's mission, and that reliable and timely information is obtained.

We found that Veterans Services does not have adequate, documented policies and procedures and this contributed to a number of problems. Detailed below are several issues resulting from the lack of this control.

### Establish and Implement Adequate Policies and Procedures over the Veterans Services Foundation

Veterans Services does not have adequate controls over Veterans Services Foundation funds, which results from a lack of detailed policies and procedures over the handling of the foundation's account. This lack of detailed policies and procedures has contributed to the inconsistent and improper processing of transactions.

During our review, we found the following issues:

- the Care Center Administrator made two personal loans to the foundation local fund account to pay for expenses;
- staff transferred money from the Veterans Services Foundation primary accounts to the local bank account to purchase presents during the holiday season. The nature of the purchase should have resulted in checks to pay vendors using the primary Veterans Services Foundation fund rather than the local bank account;
- the accounting records did not indicate donor restrictions and some unrestricted funds appeared to have use restrictions;
- checks were deposited untimely, including the misplacing of two checks totaling over \$700; and
- local fund purchases lacked adequate support.

### Establish Process for Determining Negotiated Rates

Veterans Services does not have a documented process for determining negotiated rates for assisted living residents. Instead, Veterans Services subjectively determines the negotiated rates for residents based on personal expenses, without any documentation supporting this rate determination.

By not documenting the process for determining negotiated rates, Veterans Services cannot ensure that it is consistently and fairly determining private pay rates for assisted living residents. Therefore, Veterans Services may be unfairly burdening some residents and not charging a sufficient rate for other residents.

Veterans Services should document the process used for determining negotiated rates for assisted living residents. If the rate charged to a resident is not the basic rate, Veterans Services should document the circumstances.

### Appropriately Allocate Administrative Costs

Veterans Services does not appropriately allocate administrative costs to the Department's four service areas. Without a proper allocation method and policy, Veterans Services cannot prevent the inappropriate allocation of costs. As a result, Veterans Services may receive inappropriate reimbursement for indirect costs from Medicaid or other federal grants.

Veterans Services should determine which costs are allocable and then establish an appropriate, detailed method for allocating administrative costs to the various service areas. Management should document and communicate throughout the organization how to use the cost allocation method.

### Information Systems Security Assurance

Information security risks are any activity or event that threatens the achievement of identified business objectives by compromising confidentiality, integrity, or availability of electronic information. Agencies are vulnerable to many kinds of information risks inflicting various types of damage, which can result in significant losses. To achieve information security assurance, management must understand the processes and implement applicable internal controls. To be effective, management should deploy these controls across the environment and have them embedded in the everyday process of the organization.

Veterans Services does not have adequate documented policies and procedures for security over its critical information systems. The Commonwealth Security Standard sets minimum requirements related to all aspects of the IT environment including: a business impact analysis, risk assessment, disaster recovery program, security awareness program, data security, monitoring, and controlling systems activities. Veterans Services does not satisfy these requirements. Without these policies and procedures, Veterans Services increases the risk of not identifying or protecting critical financial and operational data.

Our review of Veterans Services found that a number of employees had inappropriate access to the agency and Commonwealth systems. Veterans Services does not have adequate controls for monitoring, adding, deleting, or modifying system access. In addition, Veterans Services also does not have a formal system access review process to ensure that employees continue to only have access as needed. Without a formal approval and system review process, Veterans Services may grant inappropriate access to individuals.

### **Conclusion**

Lack of detailed policies and procedures increases the risk for errors, manipulation, or misappropriation without detection. Veterans Services should establish and follow detailed, written policies and procedures. Written policies and procedures provide management's criteria for executing the organization's operations. They should document business processes, personnel responsibilities, departmental operations, and promote uniformity in executing and recording transactions. In addition, Veterans Services management should ensure that employees understand and follow the established procedures.

### **Ensure Compliance with Applicable Laws And Regulations**

Accountability is also the expectation that managers are responsible for the quality and timeliness of program performance, controlling costs and mitigating adverse aspects of agency operations, and assuring that programs maintain their integrity and comply with applicable laws and regulations. Our review found Veterans Services did not reasonably ensure conformity and adherence to state and federal laws, regulations, and contracts. Detailed below are several issues resulting from the lack of this control.

#### **Improve Voucher Documentation and Compliance with Procurement and Payment Policies**

Veterans Services does not have adequate supporting documentation and did not follow established policies and procedures for procuring and paying vendors. We found the following:

- the inability to provide a complete and accurate contract listing;
- contract administrators not understanding their responsibilities and in some cases, which contracts were their responsibility;
- inappropriate payment made to a contractor;
- purchases of goods without following procurement and contract guidelines for soliciting and analyzing competitive bids before vendor selection;
- payments to vendors without having a contract;
- purchase orders created after receiving the goods;
- improper approval or coding of purchases; and
- duplicate payments to vendors.

In addition, Veterans Services continues to make payments under contracts that the private company, who operated the Veterans Care Center, negotiated. These contracts are outdated and Veterans Services management has no assurance that the current prices paid are competitive.

By not following policies and procedures or maintaining adequate supporting documentation for procuring goods and services, and paying vendors, Veterans Services cannot ensure they are receiving competitive prices, or that payments are appropriate, or that goods and services purchased comply with the contract or order.

Veterans Services should review all of the current contracts to determine which contracts are out of date and what is required using the Commonwealth procurement process. In addition, management needs to assess its current procurement and payment processes to ensure compliance with policies and procedures.

#### Improve Petty Cash Records and Compliance with Requirements

Veterans Services did not comply with the Commonwealth's petty cash policies. Specifically, the employees paid sales tax on a number of purchases and did not maintain adequate supporting documentation for purchases. In addition, Veterans Services made a loan to an employee out of petty cash and did not consistently perform petty cash reconciliations in a timely manner.

#### Comply with Commonwealth Human Resources Overtime Standards

Veterans Services has no policies regarding overtime leave and overtime pay for exempt and non-exempt employees. The Fair Labor Standards Act states exempt employees will not receive overtime pay or overtime leave. However, several exempt employees within Veterans Services earned overtime leave and on occasion, received compensation for the loss of unused overtime leave balances. During calendar year 2005, Veterans Services paid active employees for almost 400 hours of leave; much of this leave earned as overtime leave.

Commonwealth standards state that only non-exempt employees should earn overtime and overtime leave and payment for accrued overtime leave should occur only when the employee leaves the agency. By not properly awarding overtime leave, Veterans Services is not complying with Commonwealth standards and is facing an undue financial burden concerning overtime and overtime leave.

Veterans Services should ensure the appropriate classification of all employees under the Fair Labor Standards Act. Then, Veterans Services should only allow non-exempt employees to earn overtime and overtime leave with documented supervisory approval. Finally, Veterans Services should assess what human resource policies are currently in place and determine what policies are necessary to ensure effective human resources operations. Management should review the Commonwealth's human resources policies and procedures for guidance.

#### Implement and Monitor Procedures To Ensure Proper Use Of Funds

Veterans Services receives federal grant subsidy funds for eligible Care Center residents. Federal regulations restrict these funds and limit their use for financial assistance to states furnishing nursing home and domiciliary care to eligible veterans in state veterans' homes. Veterans Services did not classify the subsidy received as federal funds and has not coded these funds separately in the Commonwealth's accounting system, but as a special revenue fund.

Since Veterans Services did not uniquely identify these funds as federal grant funds, Veterans Services did not report the amounts expended under these grants on their Schedule of Expenditures of Federal Awards, as required by state and federal regulations. In addition, Veterans Services has not established a plan or guidelines for using the grant funds and has not actively monitored the usage of the funds for compliance with federal regulations.

By not separating the subsidy into separate accounts, Veterans Services cannot ensure that it has followed federal regulations for requesting, expending, and reporting of subsidy funds. If Veterans Services does not accurately report federal expenses on the Schedule of Expenditures of Federal Awards, Veterans Services is not complying with state and federal regulations. Non-compliance with federal regulations can lead to federal financial penalties.

Veterans Services should establish a separate account in the accounting system for the subsidy funds and classify the subsidy as federal funds. In addition, Veterans Services should establish a plan and guidelines to ensure that Veterans Services use the subsidy funds appropriately following federal regulations. Once Veterans Services has adjusted its accounting records, management can better monitor the usage and reporting of these funds to ensure compliance with regulations.

#### Improve Debt Collection Efforts and Account Write-offs

Veterans Services does not have supporting documentation to show that the Care Center complied with collection procedures for delinquent accounts. In addition, Veterans Services has not adequately assessed its past-due accounts to determine which accounts should be written-off. Further, Veterans Services does not ensure the classification of residents in the appropriate accounts receivable categories.

By not appropriately writing-off accounts, Veterans Services is overstating their accounts receivable by including accounts that are most likely uncollectible. In addition, management is unable to effectively use accounts receivable reports because these reports do not accurately reflect the Care Center's collectible accounts. Without proper classification of accounts, management is unable to properly determine where collections issues are and determine how to address these issues.

Veterans Services should retain supporting documentation for their collection efforts and properly classify their accounts. Veterans Services should review the past-due accounts and determine if there should be additional collection efforts or whether to write off the account as uncollectible.

#### Establish a Memorandum of Understanding with the Department of General Services

The Department of General Services provides Veterans Services project management services for capital outlay projects. However, Veterans Services did not establish a formal written memorandum of understanding or agreement with General Services detailing each agency's responsibilities for these construction projects.

These agreements should detail each agency's roles and responsibilities, and specifically identify who is responsible for compliance with applicable laws and regulations. Without a memorandum of understanding between the two agencies, Veterans Services management has no assurance that each party understands their role.

During our review, Veterans Services was unable to provide documentation supporting the procurement of architect and engineering services for the Sitter-Barfoot Veterans Care Center. Therefore, Veterans Services management cannot show that it complied with Commonwealth procurement guidelines for soliciting and analyzing competitive bids before vendor selection. Due to this lack of management oversight and the inadequate supporting documentation for procuring these services, Veterans Services cannot provide evidence of competitive negotiations.

The lack of a formal memorandum of understanding with the Department of General Services also resulted in the lack of adequate monitoring of the federal wage requirements. Veterans Services did not verify that the rates paid to the contractor or subcontractors complied with the prevailing wage rates required by the Davis-Bacon Act. By not monitoring the contractors and subcontractors, Veterans Services cannot show that it complied with the Davis-Bacon Act. If Veterans Services does not comply with federal regulations, questioned costs and federal financial penalties may result.

### Properly Manage Fixed Assets

Veterans Services does not have adequate controls over their fixed assets and does not consistently comply with State regulations. Veterans Services has not listed a number of fixed assets costing \$5,000 or more, including vehicles, on the Commonwealth's Fixed Asset Accounting and Control System (FAACS) and has not properly identified a number of other fixed assets. As a result, we were unable to properly identify and locate specific fixed assets during our review. In addition, Veterans Services cannot provide evidence of compliance with the Commonwealth Department-wide inventory regulations.

#### **Conclusion**

Without adequate policies and procedures that specifically address compliance, Veterans Services risks non-compliance with state and federal regulations, and increases the risk of fraud, waste, and abuse. In addition, supervisors and employees do not have sufficient guidance and may act inconsistently in making decisions.

Veterans Services should establish, implement, follow, and monitor policies and procedures that specifically address compliance and ensure that all employees understand the need to use these policies and procedures. Although some of the problems noted above result from a lack of management oversight and review, the lack of documented policies and procedures and the lack of compliance with applicable laws and regulations, arose from employees, supervisors, and management not understanding the Commonwealth's process.

We are of the opinion that many of the managers and supervisors do not fully understand their responsibilities and what is their contribution to the organization. In addition, many of the managers are not involved in the day-to-day operations of the Department. Finally, the managers and supervisors do not appear to understand how to use tools such as reconciliations and supervisory reviews to improve internal controls and the knowledge of the staff.

Veterans Services is currently in the process of implementing a new accounting system. Management believes that this new system will assist and help resolve some of the Department's internal issues. However, we believe that if Veterans Services does not first address management and policy issues, then the implementation of this system is pointless. Without resolving the underlying issues, the information that goes into the system is not accurate and reliable. Systems can only benefit an entity to the extent that the information entered is reliable and accurate.

## **AGENCY BACKGROUND**

Prior to the formation of the Department of Veterans Services, the Department of Veterans' Affairs and the Veterans Care Center Board of Trustees performed the primary functions of serving Virginia's veterans. The Department of Veterans' Affairs assisted veterans and their families in applying for veterans benefits and operated the Virginia Veterans Cemetery in Amelia, Virginia. The Virginia Veterans Care Center Board of Trustees was a separate state agency and was responsible for managing, controlling, maintaining, and operating the Virginia Veterans Care Center, a long-term care facility. The Board of Trustees contracted with various private companies to operate the center. In addition to these two primary veterans service functions, the Department of Education reviewed, approved, and monitored post-secondary education and training programs for veterans under the State Approving Agency for Veterans Education program.

In 2002, the Governor created the Governor's Advisory Commission for Veterans' Affairs. The Commission was responsible for:

- reviewing the agencies, programs, and boards currently serving the veteran community in the Commonwealth, including various fundraising activities;
- assessing the current and future projected needs of Virginia's veteran community;
- identifying current and potential future funding sources for veterans services; and
- recommending the structure, strategies, and systems for the most effective delivery of services to Virginia's veteran community.

The Advisory Commission determined that the responsibility, authority, and accountability for providing veteran services were scattered across multiple agencies, programs, and boards in the Administration Secretariat. The Commission believed that the Commonwealth's arrangement of veterans programs was derived haphazardly over time without clearly establishing priorities and was not using a consistent method to determine veterans' needs. As a result, there is an inefficient structure with administrative overlap and a lack of a clear and comprehensive mission for veterans services in the Commonwealth.

Based on their findings, the Commission suggested the restructuring of the agencies, programs, and boards into a single agency with a single policy board to establish unity of command and mission. The Commission also recommended changes in the board structure by establishing one overall veterans services policy board to address benefits, care centers, and cemeteries with specified responsibilities. In addition, the Commission made the following other recommendations:

- fill authorized caseworker vacancies in the Benefits Services section;
- establish more rigorous financial oversight and management over the care center in Roanoke starting with the findings in previous audits and investigations;
- convert the Virginia Veterans Care Center into a state-run operation based on a comprehensive operation audit to enhance the quality of care, clarify lines of authority and accountability, and allow for affordable malpractice insurance;

- develop concrete business plans for current and future operations at the current care center and the proposed Richmond care center and adopt best practices found in other states that resulted in financially viable centers; and
- consider the need for more cemeteries and adopt concrete business plans for the cemeteries.

Subsequent to the Commission's report, the General Assembly passed legislation to re-engineer existing veterans' service programs and consolidate them into a single agency. As a result of this legislation on July 1, 2003, the Department of Veterans Services (Veterans Services) came into existence to provide a "one-stop" service agency for veterans and their families. Veterans Services now serves Virginia's veterans and their dependents by ensuring that they receive the benefits, support, quality care, and recognition they have earned. Veterans Services is comprised of an administrative division and four main service divisions: benefits, cemeteries, a care center, and veterans' education.

At this time, the Department of Veterans' Affairs, the Virginia Veterans Care Center Board of Trustees, and the Virginia Veterans Cemetery Board were abolished, while three new citizen boards were established, the Board of Veterans Services, the Joint Leadership Council of Veterans Service Organizations, and the Veterans Services Foundation. The Board of Veterans Services is responsible for reviewing the Commonwealth's existing veterans' services and recommending changes and improvements. The Joint Leadership Council of Veterans Service Organizations provides a vehicle for veterans' service organizations to collaborate with the Department of Veterans Services for meeting the needs of Virginia's veterans. The Veterans Services Foundation is responsible for raising funds, identifying existing revenue sources for veterans programs, and administering the Veterans Services Fund.



## **AGENCY OPERATIONS**

Veterans Services has four service delivery branches (benefits, cemeteries, care centers, and veterans' education) and an administrative section. These branches work with the three board-type entities: the Boards of Veterans Services, the Joint Leadership Council of Veterans Service Organizations, and the Veterans Services Foundation to support the delivery of services to Virginia's veterans.

### **Benefits**

The United States Department of Veterans Affairs provides benefits and services to veterans of the armed forces. These benefits include compensation for service-connected disability or death, income-based pensions, medical care, educational benefits, and home purchase assistance.

The Benefits Service Division assists Virginia's veterans in gaining information and access to the federal benefits and services for which they are eligible. The Benefits Service Division operates a total of 15 field offices across Virginia to provide assistance to eligible veterans. In addition to the field offices, the division also operates 25 itinerant service points to serve veterans. Various government agencies and private entities provide the space for these additional service points. In fiscal year 2005, the United States Department of Veterans Affairs approved 70 percent of the 18,550 claims submitted with help from these offices.

### **Cemeteries**

The Cemeteries Services Division operates two state-owned and operated cemeteries, the Virginia Veterans Cemetery in Amelia and the Albert G. Horton, Jr. Memorial Veterans Cemetery in Suffolk. These cemeteries provide a final resting place for veterans and their eligible dependents.

### **Care Centers**

At the beginning of fiscal year 2004, Veterans Services became responsible for operating the Virginia Veterans Care Center in Roanoke, Virginia. The Care Center provides long-term health care for up to 240 veterans in 120 semi-private rooms. Of the facility's 240 beds, 180 are skilled nursing care beds (including 60 set aside for Alzheimer's patients) and the remaining 60 beds are for assisted-living patients. In fiscal year 2005, the facility had a total average occupancy rate of 94 percent (93 percent in skilled nursing care section and 97 percent in assisted-living section). Table 1 shows the Care Center's patient days and average occupancy level by month for fiscal year 2005.

Table 1

Fiscal Year 2005 Care Center Patient Days and Occupancy Rates

Month	Patient Days Nursing	Average Number of Nursing Beds Occupied	Occupancy Level: Nursing	Patient Days Assisted Living	Average Number of Assisted Living Beds Occupied	Occupancy Level: Assisted Living
July	5,303	171	95%	1,757	53	94%
August	5,292	171	95%	1,775	51	95%
September	4,984	161	92%	1,707	50	95%
October	5,207	168	93%	1,758	49	95%
November	5,002	161	93%	1,769	50	98%
December	5,279	170	95%	1,816	51	98%
January	5,191	167	93%	1,650	51	89%
February	4,792	155	95%	1,504	53	90%
March	5,263	170	94%	1,664	56	89%
April	4,984	161	92%	1,773	58	99%
May	5,099	164	91%	1,788	58	96%
June	<u>4,896</u>	<u>158</u>	<u>91%</u>	<u>1,627</u>	<u>57</u>	<u>90%</u>
Average	<u>5,108</u>	<u>165</u>	<u>93%</u>	<u>1,716</u>	<u>53</u>	<u>94%</u>

Source: Department's 2005 Annual Report

### **Veterans Education**

In January 2004, Veterans Services assumed the State Approving Agency for Veterans Education from the Department of Education. This function reviews, evaluates, and approves post-secondary education and training programs offered by educational institutions and various other entities within Virginia. Once the program receives approval, veterans and other eligible individuals may enroll and receive federal financial education assistance. Veterans Services monitors the approved education and training programs to ensure compliance with applicable federal and state regulations.

### **Administrative Services**

The Administrative Services Division provides the other four service divisions support in the following areas: accounting, budget, human resources, information technology, payroll, and procurement.

### **Veterans Services Foundation**

The Veterans Services Foundation serves as an advisory foundation within the executive branch of state government. The Veterans Services Foundation raises funds, identifies existing revenue sources for veterans programs, and administers the Veterans Services Fund. The Department of Veterans Services processes the Foundation's transactions.

## FINANCIAL INFORMATION

Table 2 summarizes Veterans Services' total operating expenses incurred by program area for fiscal years 2004 and 2005. Of the Veterans Services' \$17.8 million in operating expenses for fiscal year 2005, 50 percent is for personal services.

Table 2

### Operating Expenses by Fiscal Year and Program

<u>Program</u>	<u>FY 2005</u>	<u>FY 2004</u>
Care center	\$14,243,486	\$11,984,187
Benefits	1,990,006	2,536,340
Veterans education	405,901	191,262
Administrative services	876,276	500,174
Cemeteries	<u>282,029</u>	<u>-</u>
Total	<u>\$17,797,698</u>	<u>\$15,211,963</u>

Table 3

### Operating Expenses by Major Category

<u>Category</u>	<u>FY 2005</u>	<u>FY 2004</u>
Personal services	\$11,007,621	\$10,089,684
Contractual services	2,792,451	2,165,006
Supplies and materials	2,203,467	1,786,478
Transfer payments	10,929	339,109
Rent and other continuous charges	1,344,983	680,805
Equipment	154,780	146,629
Plant and Improvements	<u>283,467</u>	<u>4,252</u>
Total	<u>\$17,797,698</u>	<u>\$15,211,963</u>

In addition to the operating expenses shown above, Veterans Services also spent over \$1.8 on two capital projects in fiscal year 2005. Veterans Services currently has two outstanding capital projects. Veterans Services is constructing a new 160-bed care center, the Sitter-Barfoot Veterans Care Center, in Richmond, Virginia, with completion scheduled for mid-2007. In addition, Veterans Services is completing general renovations and constructing storage and laundry facilities at the Virginia Veterans Care Center in Roanoke. The table below summarizes the appropriations and expenses for fiscal year 2005 for both capital projects.

Table 4

### Appropriations and Actual Expenses for Two Major Capital Projects

	<u>Appropriations</u>	<u>FY 2005 Expenses</u>
Sitter-Barfoot Veterans Care Center	\$22,692,000	\$1,376,960
Renovations and storage and laundry facility construction	2,081,000	-

Veterans Services projected expenses for fiscal year 2006 at \$8.7 million for the Sitter-Barfoot Veterans Care Center and \$1.3 million for the Virginia Veterans Care Center's renovations and storage and laundry facility construction. Veterans Services has had no major modifications for either project.

The following table shows the funds available and the total expenses by program for fiscal year 2005. Some programs, such as the Care Center, do not expend all of the program funds available and therefore subsidize those programs, such as the Veterans Education and Cemeteries programs, that do not receive enough revenue and General Fund appropriations to cover expenses.

Table 5

Funds Available and Actual Expenses by Program for Fiscal Year 2005

<u>Program</u>	<u>Funds Available *</u>	<u>Expenses**</u>	<u>Difference</u>
Care Center	\$14,500,928	\$14,243,486	\$257,442
Benefits	2,314,032	1,990,006	(324,026)
Veterans education	232,165	405,901	(173,736)
Administrative services	907,030	876,276	30,754
Cemeteries	269,724	282,029	(12,305)

\* Includes Revenue less Refunds, Net Cash Transfers, and General Fund Appropriations

\*\*Includes Expenses less Refunds

Table 6 summarizes Veterans Services' original and final budget to their actual expenses.

Table 6

Budget to Actual Expenses for Fiscal Year 2005

<u>Program</u>	<u>Original Budget</u>	<u>Final Budget</u>	<u>Expenses</u>
Care Center	\$11,424,406	\$14,243,969	\$14,243,485
Benefits	2,200,095	2,279,732	1,990,006
Veterans education	473,194	488,254	405,901
Administrative services	530,631	1,120,985	876,276
Cemeteries	301,654	502,870	282,029
Total	\$14,929,980	\$18,635,810	\$17,797,697

The Care Center's original fiscal year 2005 operating budget increased by about 25 percent. This increase was primarily the result of the Department of Planning and Budget re-appropriating about \$1.3 million in special revenue funds from the fiscal year 2004 fund balance and the legislature approving an additional \$1.6 million appropriation for the Care Center because of an expected increase in special revenues. Veterans Services also opened their second cemetery, which required additional funding.



# Commonwealth of Virginia

Auditor of Public Accounts  
P.O. Box 1295  
Richmond, Virginia 23218

Walter J. Kucharski, Auditor

June 22, 2006

The Honorable Timothy M. Kaine  
Governor of Virginia  
State Capital  
Richmond, Virginia

The Honorable Thomas K. Norment, Jr.  
Chairman, Joint Legislative Audit  
and Review Commission  
General Assembly Building  
Richmond, Virginia

We have audited the financial records and operations of the **Department of Veterans Services and the Veterans Services Foundation** for the period beginning January 1, 2005 and ending March 31, 2006. We conducted our audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

## Audit Objectives

Our audit's primary objective was to review the significant cycles for the Department of Veterans Services' activities as reported in the Commonwealth Accounting and Reporting System (CARS). In support of this objective, we evaluated the accuracy of recording financial transactions in CARS, reviewed the adequacy of Veterans Services' internal controls, tested for compliance with applicable laws, regulations, contracts, and grant agreements, and reviewed corrective actions of audit findings from prior year reports.

## Audit Scope and Methodology

The Department of Veterans Services' management has responsibility for establishing and maintaining internal control and complying with applicable laws and regulations. Internal control is a process designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

We gained an understanding of the overall internal controls, both automated and manual, sufficient to plan the audit. We considered materiality and control risk in determining the nature and extent of our audit procedures. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances:

- Revenues
- Fixed assets
- Expenditures (including payroll)
- Network Security
- Cash receipting and collections of accounts receivable

We performed audit tests to determine whether the Agency's controls were adequate, had been placed in operation, and were being followed. Our audit also included tests of compliance with provisions of applicable laws and regulations. Our audit procedures included inquiries of appropriate personnel, inspection of documents, records, and contracts, and observation of the Agency's operations. We tested transactions and performed analytical procedures, including budgetary and trend analyses.

### Conclusions

We found that the Department of Veterans Services properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System. The Department of Veterans Services records its financial transactions on the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The financial information presented in this report came directly from the Commonwealth Accounting and Reporting System.

We noted certain matters involving internal control and its operation and compliance with applicable laws and regulations that require management's attention and corrective action. These internal control findings collectively represent a material weakness. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial processes being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. These matters are described in the section entitled "Internal Control and Compliance Findings."

The Department has taken adequate corrective action for only one of six audit findings reported in the prior year. The Department has not taken adequate corrective action with respect to the prior findings regarding strengthening controls over the small purchase charge card program, establishing and implementing adequate policies and procedures over the Veterans Services Foundation, improving voucher documentation and compliance with procurement and payment policies, and improving debt collection efforts and account write-offs.

### **EXIT CONFERENCE**

We discussed this report with management on July 12, 2006. Management's response has been included at the end of this report.

This report is intended for the information and use of the Governor and General Assembly, management, and the citizens of the Commonwealth of Virginia and is a public record.

AUDITOR OF PUBLIC ACCOUNTS

NJG/kva



# COMMONWEALTH of VIRGINIA

## *Department of Veterans Services*

### *Office of the Commissioner*

Vincent M. Burgess  
Commissioner

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vince.burgess@dvs.virginia

July 18, 2006

Mr. Walter J. Kucharski  
Auditor of Public Accounts  
P. O. Box 1295  
Richmond, Virginia 23218

Dear Walt:

Thank you for the opportunity to respond to the 2005 audit findings for the Department of Veterans Services (DVS). The audit was comprehensive and the points and discussion that you outline relating to internal controls are quite relevant. Your findings will be given full consideration in our plan of correction. We will take the management and administrative actions necessary to make DVS an efficient and effective agency, as intended with the 2003 consolidation of veterans services.

As you noted, many of the daily operations remain aligned with staff in the Roanoke area, as they did before the consolidation of veterans services. The growth of the agency and evolving role of the Commissioner's Office in Richmond, along with the location of the administrative functions, has been a challenge to the staff and to changing the culture of this agency. Addressing these audit findings along with the full implementation of the new financial system (FMS), and the opening of the new Sitter-Barfoot Veterans Care Center (SBVCC) in Richmond in 2007 must be done properly and taken as an opportunity to complete the management and organizational changes envisioned with the creation of DVS and establishment of a central office in Richmond.

The following audit findings will require comprehensive actions including organizational, personnel, budget and system changes that may take up to two years to fully address. Specific comments to each of these findings follow.

#### **Voucher Documentation and Compliance with Procurement and Payment Policies**

I have requested a review of the procurement operations by the Department of General Services (DGS), which is scheduled for August, 2006. This area definitely has operational issues relating to performance, communications, lines of authority and separation of duties. These issues must

be addressed before we open the SBVCC. I will look at a number of significant alternatives for the provision of procurement, as soon as the DGS review is completed.

**Implement and Monitor Procedures to Ensure Proper Use of Funds (VA Subsidy)**

DVS has already corrected the accounting classification for the federal VA subsidy funds, from non-general to Federal Trust, for reporting to the Departments of Accounts and Planning and Budget. We presently are reviewing the budget practices and use of these funds at the Virginia Veterans Care Center (VVCC), and a plan will be produced for utilization of these funds for operational, capital and financial assistance for resident services.

**Establish Process for Determining Negotiated Rates**

Policies and procedures for negotiating rates for assisted living residents will be developed. These policies will take into consideration the proper utilization and allocation of the VA subsidy as a means of providing financial assistance through negotiated rates to residents.

**Appropriately Allocate Administrative Costs**

Changes have been implemented for fiscal year 2007 in the allocation of administrative costs as related to the Roanoke administrative offices and the VVCC. In order to fully address this issue and properly budget for the administrative operations of DVS, additional general funds may be necessary. Direct program areas do not have sufficient general funds to support both their operations and administrative overhead for the agency. As noted in your finding, the care centers cannot be expected to fund more than actual allowable costs.

**Information Systems Security Assurance**

A recent policy was published relating to controls over veterans information and the use of personal laptop computers by staff. The new FMS has an extensive and documented security system. We expect to be able to use these security features in strengthening other information systems. As noted in your report, this is an area of vulnerability for agencies in general. The development of comprehensive policies and procedures and integration into the daily operations of DVS will likely require outside assistance from the Virginia Information Technologies Agency (VITA) or other sources, as well as additional resources.

We already have begun implementing new policies and procedures on a number of the audit points. I expect full corrective action to occur within the next six months and prior to the next APA audit for the following findings:

- Accurate time and leave reporting
- Compliance with human resource overtime standards
- Controls over small purchase charge card program
- Capital outlay construction-in-progress reporting
- Policies and procedures for Veterans Services Foundation funds
- Memorandum of Understanding with DGS
- Fixed asset management and reporting



Mr. Walter J. Kucharski  
July 18, 2006  
Page 3

- Bad debt collection efforts and account write-offs
- Petty cash controls

I appreciate the efforts of your staff on this audit and particularly your comments and suggestions at the exit conference. Please contact me if you have any questions or comments about our response.

Sincerely yours,



Vincent M. Burgess

cc: The Honorable John W. Marshall  
Secretary of Public Safety

The Honorable Clyde E. Cristman  
Deputy Secretary of Public Safety

Mr. Paul Galanti  
Chairman of the Board of Veterans Services

Mr. J. Armistead Ransone  
Director of Finance and Administration

DEPARTMENT OF VETERANS SERVICES

Vincent M. Burgess  
Commissioner

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